A Report
to the
Montana
Legislature

Financial-Compliance Audit

Teachers' Retirement System

For the Fiscal Year Ended June 30, 2014

February 2015

Legislative Audit Division

14-09A

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LEGISLATIVE AUDIT DIVISION

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Cindy Jorgenson
Angus Maciver

February 2015

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit of the Teachers' Retirement System (system), a component unit of the state of Montana, for the fiscal year ended June 30, 2014. Included in this report are the Independent Auditor's Report, financial statements prepared by system personnel, related notes to the financial statements, Required Supplementary Information, and Supplementary Information. The Required Supplementary Information includes the Schedule of Changes in the Net Pension Liability, Schedule of the Net Pension Liability, TRS Plan Schedule of Investment Returns, Schedule of Employer and Non-Employer Contributing Entities Contributions, and Other Postemployment Benefits Plan Information Schedule of Funding Progress. Supplementary Information includes the Schedule of Administrative Expenses, Schedule of Investment Expenses, and Schedule of Payments to Consultants.

The system's response to our audit is on page B-1. We thank the executive director and his staff for their cooperation and assistance during the audit.

Respectfully submitted,

/s/ Tori Hunthausen

Tori Hunthausen, CPA
Legislative Auditor

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SYSTEM RESPONSE
Teachers' Retirement System B-1

Appointed and Administrative Officials

			Term Expires
Teachers' Retirement Board	Kari Peiffer, Chair	Kalispell	July 2017
	Scott Dubbs, Vice Chair	Lewistown	July 2018
	Lisa Cordingly	Helena	July 2015
	Janice Muller	Hamilton	July 2016
	Marilyn Ryan	Missoula	July 2016
	Daniel Trost	Helena	July 2019

Administrative Officials	Shawn Graham, Executive Director
	Tammy Rau, Deputy Executive Director
	Nolan Brilz, Accounting and Fiscal Manager

For additional information concerning the Teachers' Retirement System, contact:

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Montana Legislative Audit Division

Financial-Compliance Audit
Teachers' Retirement System
For the Fiscal Year Ended June 30, 2014

February 2015 14-09A Report Summary

In fiscal year 2014, the Teachers' Retirement System had net investment income of $540.3 million, which contributed to an increase of net position of $467.1 million. In July 2014, that actuarial valuation indicated the system is actuarially sound and able to amortize the unfunded accrued liability in 28 years with the current 1.5 percent guaranteed annual benefit adjustment .

Context

Teachers' Retirement System (system) is a component unit of the state of Montana. Statutorily, full-time members of the public teaching profession, including administrative and professional staff, are required to be members of the system. Certain eligible employees of the Montana University System hired after July 1, 1993, are not required to be members.

At July 1, 2014, the system had more than 18,200 active members. During fiscal year 2014, members contributed $70.5 million, employers contributed $83.4 million, and in total, including supplemental contributions, $218.8 million was contributed to the system. In contrast, $285.2 million in benefits were paid to approximately 14,349 members or their beneficiaries during the fiscal year.

The Montana Constitution requires the system to be funded on an actuarially sound basis. The July 1, 2014, actuarial valuation indicated the system's amortization period is 28 years. During the 2013 Legislative Session, bills were passed that decreased the guaranteed annual benefit adjustment (GABA) to 0.5 percent. However, as a result of a court ordered preliminary injunction regarding the GABA decrease, the GABA rate remained at 1.5 percent for fiscal year 2014. The 1.5 percent rate was used to calculate the amortization period noted above.

In addition to decreasing the GABA, 2013 legislation increased funding for the system. Per new legislation, the system received an annual supplemental contribution from the general fund in the amount of $25 million. In addition to the general fund contributions, a supplemental contribution of 1 percent was added to the employer contribution rate. Annually, through the year 2024, an additional 0.1 percent will be added to the employer contribution rate. The 2013 legislation also created a two-tier membership system classifying members based on the date of entry into the system.

Effective fiscal year 2014, the system implemented a new accounting standard changing retirement system financial reporting requirements. These standards specify the required approach to measuring the net pension liability of employers for benefits provided through the pension plan. The fiscal year 2014 financial statement notes and required supplementary information disclose the total and net pension liability for the system as well as additional investment and contributions data.

Our audit work over the system included sample testing of contributions and benefits and testing significant system controls. As part of our audit, we also reviewed the presentation

(continued on back)

of the system's financial statements and note disclosures to determine whether they were supported by the underlying accounting records and the actuarial valuation. We also tested key employee data for retirement system members, as this information is used by the system's actuary to calculate the total pension liability.

Results

The report does not contain recommendations and we issued an unmodified opinion on the system's financial statements for fiscal year 2014. This means the reader can rely on the information presented in the financial statements.

For a complete copy of the report (14-09A) or for further information, contact the Legislative Audit Division at 406-444-3122; e-mail to **lad@mt.gov**; or check the web site at **http://leg.mt.gov/audit**
Report Fraud, Waste, and Abuse to the Legislative Auditor's FRAUD HOTLINE
Call toll-free 1-800-222-4446, or e-mail **ladhotline@mt.gov**.

Chapter I – Introduction

Introduction

We performed a financial-compliance audit of the Teachers' Retirement System (system) for the fiscal year ended June 30, 2014. The objectives of our audit were to:

1. Determine if the system's financial statements present fairly, in all material respects, the financial position of the system and the results of operations for the fiscal year ended June 30, 2014.
2. Obtain an understanding of the system's controls to the extent necessary to support our audit of the system's financial statements and, if appropriate, make recommendations for improvement in the internal and management controls of the system.
3. Determine if the system complied with selected laws and regulations.

The financial statements are prepared by system personnel from the underlying accounting records with adjustment. Adjustments are made to accurately present financial activity in accordance with Generally Accepted Accounting Principles (GAAP). The system also issues a separate comprehensive annual financial report.

Effective fiscal year 2014, the system implemented a new accounting standard changing retirement system financial reporting requirements. The standards on financial reporting for pensions specify the required approach to measuring the pension liability of employers for benefits provided through the pension plan. The fiscal year 2014 financial statement notes and required supplementary information disclose the total and net pension liability for the system as well as additional investment and contributions data. Total pension liability is the actuarial present value of projected benefit payments that is attributable to past periods of member services. The net pension liability is a new measure of the extent to which the net pension liability is covered by the fiduciary net position of the pension plan. The total pension liability and net pension liability for the system at June 30, 2014, were $5.1 billion and $1.5 billion, respectively.

Our audit work included testing member contributions and retiree benefit payments through samples to ensure contributions made and benefits paid were in accordance with state law and system requirements, as well as testing significant controls designed by system personnel to prevent and/or detect errors. As part of our audit, we also reviewed the presentation of the system's financial statements and note disclosures to determine they were supported by the underlying accounting records and the actuarial valuation as of June 30, 2014. We also tested important employee data for retirement

system members, as this information is used by the system's actuary to calculate the total pension liability. Through samples at 32 employers, we tested the accuracy and completeness of key member data such as gender, birthdate, hire date, salary, and employment status.

Background

The system is defined as a multiple-employer, cost-sharing defined-benefit, public pension plan. Full-time members of the public teaching profession, including administrative and professional staff, are required to be members of the system. Certain eligible employees of the Montana University System hired after July 1, 1993, are not required to be members.

The system is a component unit of the state of Montana. A component unit is a legally separate organization for which the state of Montana is financially accountable. The system had 18,272 active contributing members and 13,962 terminated employees not yet receiving benefits at July 1, 2014. Approximately 14,349 retirees or their beneficiaries were receiving retirement, disability, or survivor benefits as of July 1, 2014.

A six-member board, appointed by the Governor for five-year terms, governs the system. In addition to providing oversight to system personnel, the board's responsibilities include establishing rules and regulations necessary for the administration and operation of the system, and hiring an actuary to provide consultation on the technical actuarial aspects of the retirement system.

The Executive Director and system personnel are responsible for the daily administration of the system. At June 30, 2014, 18 full-time equivalent (FTE) positions were authorized for the system.

The 2013 Legislature passed legislation that created a two-tier benefit structure and provided additional funding to the system. The new tier system classifies members based on when they first became a member, either before or after July 1, 2013. Differences between the two tiers include:

- Tier two uses a 5-year average final compensation as opposed to a 3-year average for tier one.
- Tier two provides for early retirement benefits with 5 years of service at age 55, rather than at age 50 for tier one.
- Tier two has a higher normal employee contribution rate than tier one, however, with a temporary supplemental contribution for tier one, the employee rates are the same at both tiers.

In addition to the creation of the tier system, the following changes were made to provide additional funding to the system:

- The guaranteed annual benefit adjustment (GABA) was reduced from 1.5 percent to 0.5 percent. However, a court ordered preliminary injunction regarding the decrease caused the GABA rate to remain at 1.5 percent for fiscal year 2014.
- A 1 percent supplemental contribution was added to employer contribution rates.
- An annual supplemental general fund contribution was established in the amount of $25 million.
- A one-time retirement reserve sweep of $22 million was made from school districts with reserves in excess of 20 percent of the retirement fund budget for fiscal year 2013.

Independent Auditor's Report and System Financial Statements

LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Deborah F. Butler, Legal Counsel

Deputy Legislative Auditors:
Cindy Jorgenson
Angus Maciver

Independent Auditor's Report

The Legislative Audit Committee
of the Montana State Legislature:

Introduction

We have audited the accompanying Statement of Plan Net Position of the Teachers' Retirement System, a component unit of the State of Montana, as of June 30, 2014, and the related Statement of Changes in Plan Net Position for the fiscal year then ended, and the related notes which collectively comprise the system's basic financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this responsibility includes designing, implementing, and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the system's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the system's internal control, and accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as the overall presentation of the financial statements.

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We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the net position of the Teachers' Retirement System as of June 30, 2014 and the changes in net position for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note D to the financial statements, the system implemented Governmental Accounting Standards Board Statement No. 67, Financial Reporting for Pension Plans, in fiscal year 2014. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, Schedule of Changes in Net Pension Liability, Schedule of the Net Pension Liability, TRS Plan Schedule of Investment Returns, Schedule of Employer and Non-Employer Contributing Entities Contributions, and Other Postemployment Benefits Plan Information Schedule of Funding Progress be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The Schedule of Administrative Expenses, Schedule of Investment Expenses, and Schedule of Payments to Consultants are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the

financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

January 23, 2015

TEACHERS' RETIREMENT SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis of the Montana Teachers' Retirement System's (TRS) provides a narrative overview of the TRS's financial activities for the fiscal year ended June 30, 2014.

Overview of the Financial Statements

The TRS 2014 financial statements, notes to the financial statements, and required supplementary information were prepared in conformity with GASB Statement No. 67, *Financial Reporting for Pension Plans*.

Because of the long-term nature of a defined benefit pension plan, financial statements alone cannot provide sufficient information to properly reflect the System's ongoing plan perspective. The Statement of Plan Net Position reflects the resources available to pay benefits to retirees and beneficiaries. The Statement of Changes in Plan Net Position presents the changes that occurred in those resources for the fiscal year ended June 30, 2014.

The Notes to the Basic Financial Statements provide additional information that is essential to gain a full understanding of the data provided in the basic financial statements. The required supplementary information consists of four schedules of changes of employers' net pension liability, employers' net pension liability, employer contributions, and the money-weighted rate of investment returns of the defined benefit pension system administered by TRS.

Financial Highlights

- The TRS plan net position increased by $467.1 million for 2014; representing an increase of 14.7% from the previous fiscal year.
- The TRS plan net investment income was $540.3 million at FYE 2014. This represents a 44.6% increase over the previous fiscal year. The increase was due to the strong rate of return on investments in FY 2014.
- The TRS plan rate of return on investments during FY 2014 was 17.1% compared with FY 2013 rate of return of 12.1%. The increase in rate of return was primarily due to an increase in market performance and an improved economy in FY 2014.
- The TRS benefit payments paid to benefit recipients increased 6.7% to $285.2 million for FY 2014, which is consistent with prior years.
- The TRS plan had a Net Pension Liability of $1.54 billion and a Net Pension Liability as a percentage of covered payroll was 205.0% as of June 30, 2014

Condensed Financial Information (in millions)

For comparative purposes, the Condensed Financial Information below is presented with FY 2013 financial information. (Presented in Millions)

Plan Net Position	FY2014	FY2013	Percent Inc/(Dec)
Cash/Short-term Investments	$ 85.8	$ 49.3	75.9%
Receivables	27.2	22.9	18.8%
Investments (fair value)	3,691.3	3,254.7	13.4%
Other Assets (net)	0.6	0.1	500.0%
Total Assets	3,804.9	3,327.0	14.4%
Liabilities	152.7	141.9	7.7%
Net Position	**$3,652.2**	**$3,185.1**	**14.7%**

Changes in Plan Net Position	FY2014	FY2013	Percent Inc/(Dec)
Additions:			
Employer Contributions	$ 83.4	$ 74.1	12.6%
Plan Member Contributions	70.5	62.8	12.3%
Other Contributions	64.9	17.5	270.8%
Net Investment Income	540.3	373.7	44.6%
Total Additions	759.1	528.2	43.7%
Deductions:			
Benefit Payments	285.2	268.3	6.3%
Withdrawals	4.8	5.1	(5.9%)
Administrative Expenses	2.1	1.9	10.5%
Total Deductions	292.1	275.3	16.8%
Net Inc/(Dec) in Plan Net Position	**$ 467.2**	**$ 252.9**	**84.7%**

Financial Analysis

- The change from year-to-year in cash/short-term investments was due to the change in the number of shares held, at a per share value of $1, in the Short Term Investment Pool.
- The increase in Contributions was due to HB 377 provisions that took effect in 2014 that increased contribution rates.
- The increase in Other Contributions was due to HB 377 provisions that took effect in 2014 that created a one-time Retirement Reserve Sweep payment from School Districts as well as an annual supplemental $25 million from the State general fund
- The increase in investments for 2014 represents the continued recovery in the economy and capital market conditions.

- The increase in net investment income for 2014 was due to an overall increase in the market value of investment holdings as the market increased based on positive corporate profits. Furthermore, the economy continued its steady growth.
- The increase in Other Assets was due to the plans investment in an upgrade to the current Pension Administration System. The system will be implemented in stages and the overall cost will be capitalized. The 2014 costs of $499,184 were recorded as Intangible Assets.
- The increase in benefit payments from year-to-year reflects an increase in the number of retirees and beneficiaries plus the 1.5% guaranteed annual benefit adjustment.

Overview of the Actuarial Funding

An actuarial valuation of the System is performed annually. As of July 1, 2014, the date of the most recent actuarial valuation, the funded ratio of the System was 65.5%. This was a decrease from the System's July 1, 2013 valuation funded ratio of 66.8%. The funded ratio decrease for the system was the result of an increase in the GABA rate from 0.5% to 1.5%, due to a court ordered preliminary injunction.

In determining contribution rates, an actuarial value of assets is used rather than a market value of assets. The actuarial value of assets is based on a smoothed income investment rate. The TRS plan experienced an asset gain over the last year. The market value of assets had a positive return of 17.09% net of investment and operating expenses. The actuarial value of assets earned 13.21%, which is 5.46% greater than the actuarial assumption of 7.75%. Actuarial gains or losses result when the return on the actuarial value of assets differs from the actuarial investment return assumption. The following table compares the annual returns for the past three fiscal years.

Fiscal Year	Market Return	Actuarial Return	Actuarial Return over/(under) 7.75 %
7/1/2011 to 6/30/2012	2.21%	3.21%	(4.54)%
7/1/2012 to 6/30/2013	12.94%	11.99%	4.24%
7/1/2013 to 6/30/2014	17.09%	13.21%	5.46%

As of July 1, 2014, the System's unfunded actuarial accrued liability was $1.8 billion. This was a net increase in the unfunded position of $269 million compared to July 1, 2013.

Every four years, in conjunction with the actuarial valuation the actuary performs an experience study. Based upon the 2014 experience study, the actuary recommended some changes in the actuarial assumptions that were adopted by the Board. Changes include: updating the mortality tables used for healthy and disabled retirees, the assumed rate of inflation was reduced from 3.50% to 3.25%, the payroll growth assumption was reduced from 4.50% to 4.00%, assumed real wage growth was reduced from 1.00% to .075%, investment return assumption was changed from net of investment and administrative expenses to net of investment expense only. The Board adopted the current economic assumption for return on investment of 7.75%.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
STATEMENT OF PLAN NET POSITION
FISCAL YEAR ENDED JUNE 30, 2014

		2014
ASSETS		
Cash/Cash Equivalents-Short Term		
Investment Pool (Note B)	$	85,840,583
Receivables:		
Accounts Receivable		23,220,600
Interest Receivable		3,938,077
Total Receivables	$	27,158,677
Investments, at fair value (Note B):		
Equity in Pooled Investments	$	3,538,421,770
Other Investments		826,188
Securities Lending Collateral (Note B)		152,071,669
Total Investments	$	3,691,319,626
Assets Used in Plan Operations:		
Land and Buildings	$	193,844
Less: Accumulated Depreciation		(150,545)
Equipment		206,696
Less: Accumulated Depreciation		(132,925)
Prepaid Expense		0
Intangible Assets, net of amortization		499,184
Total Other Assets	$	616,255
TOTAL ASSETS	$	3,804,935,140
LIABILITIES		
Accounts Payable	$	249,081
Securities Lending Liability (Note B)		152,071,669
Compensated Absences (Note B)		153,797
OPEB Implicit Rate Subsidy (Note F)		240,329
TOTAL LIABILITIES	$	152,714,875
NET POSITION RESTRICTED FOR PENSION BENEFITS	**$**	**3,652,220,265**

The accompanying Notes to the Financial Statements are an integral part of this financial statement.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
STATEMENT OF CHANGES IN PLAN NET POSITION
FISCAL YEAR ENDED JUNE 30, 2014

		2014
ADDITIONS		
Contributions:		
Employer	$	83,439,612
Plan Member		70,468,354
Other		64,923,320
Total Contributions	$	218,831,287
Miscellaneous Income	$	6,000
Investment Income:		
Net Appreciation/(Depreciation)		
in Fair Value of Investments	$	404,310,911
Investment Earnings		155,346,249
Security Lending Income (Note B)		750,702
Investment Income/(Loss)	$	560,407,862
Less: Investment Expense		20,013,455
Less: Security Lending Expense (Note B)		117,044
Net Investment Income/(Loss)	$	540,277,362
TOTAL ADDITIONS	$	759,114,649
DEDUCTIONS		
Benefit Payments	$	285,182,358
Withdrawals		4,788,688
Administrative Expense		2,022,636
OPEB Expenses (Note F)		58,073
TOTAL DEDUCTIONS	$	292,051,755
NET INCREASE (DECREASE)		
IN FIDUCIARY NET POSITION	$	467,062,894
NET POSITION RESTRICTED		
FOR PENSION BENEFITS		
BEGINNING OF YEAR		3,185,064,406
Prior Period Adjustment		92,965
END OF YEAR	**$**	**3,652,220,265**

The accompanying Notes to the Financial Statements are an integral part of this financial statement.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
NOTES TO THE FINANCIAL STATEMENTS
FISCAL YEARS ENDED JUNE 30, 2014

NOTE A. DESCRIPTION OF THE PLAN

Teachers' Retirement System is a mandatory-participation multiple-employer cost-sharing defined-benefit public pension plan that provides retirement services to individuals employed as teachers, administrators, and in other professional and skilled positions employed in public education in Montana.

The TRS Board and staff administer the retirement system in conformity with the law set forth in Title 19, chapter 20 of the Montana Code Annotated, and administrative rules set forth in Title 2, chapter 44 of the Administrative Rules of Montana. Additional information pertaining to membership, benefit structure, and prior years' actuarial valuations, as well as links to applicable statutes and administrative rules, may be obtained by visiting the TRS web site at www.trs.mt.gov.

The Teachers' Retirement Board is the governing body of the System, which provides retirement services to persons in Montana employed as teachers or professional staff of any public elementary or secondary school, community college, or unit of the university system. The system was established by the State of Montana in 1937 to provide retirement, death, and disability benefits and is governed by Title 19, chapter 20, of the MCA. TRS as an employer does not participate in the plan and acts only as the administrator of the plan.

Board Composition

The Teachers' Retirement Board consists of six members, all appointed by the Governor. Three Board members must be teaching professionals who, when appointed, are active members of TRS; at least one of them must be an active classroom teacher. One Board member must be a retired teacher who was a member of TRS at the time of retirement. Two Board members are appointed from the public at large. TRS Board members serve staggered five year terms. Three Board members constitutes a quorum.

Reporting Entities

At June 30, 2014, the number and type of reporting entities participating in the system were as follows:

Local School Districts & Co-ops	351
Community Colleges	3
University System Units	2
State Agencies	9
Total	365

System Membership

At July 1, 2014, the date of the most recent actuarial valuation, system membership consisted of the following:

Retirees and Beneficiaries Currently Receiving Benefits	14,349
Terminated Members:	
Vested	1,654
Non-vested	12,308
Active Plan Members:	
Full-Time	12,286
Part-Time	5,986
Total Membership	46,583

Summary of Benefits

Through June 30, 2013, all members enrolled in TRS participated in a single-tiered plan ("Tier One"). Employees with a minimum of 25 years of service or who have reached age 60 with 5 years of service are eligible to receive an annual retirement benefit equal to creditable service years divided by 60 times the average final compensation. Final compensation is the average of the highest three consecutive years of earned compensation. Benefits fully vest after 5 years of creditable service. Vested employees may retire at or after age 50 and receive reduced retirement benefits. Beginning July 1, 2013, new members in TRS participate in a second benefit tier ("Tier Two"), which differs from Tier One as follows:

- Tier Two uses a 5-year average final compensation (as opposed to 3-year AFC in Tier One)
- Tier Two provides for unreduced service retirement benefits at age 60 with 5 years of creditable service or at age 55 with at least 30 years of creditable service (rather than at age 60 with 5 years of service or at any age with creditable service in 25 years in Tier One)
- Tier Two provides for early retirement benefits with 5 years of creditable service at age 55 (rather than age 50 in Tier One)
- Tier Two has a one percent higher normal employee contribution rate (though a temporary 1% supplemental employee contribution rate is also now currently in place for Tier One members), and
- Tier Two provides for an enhanced benefit calculation - 1.85% x AFC x years of creditable service - for members retiring with at least 30 years of creditable service and at least 60 years of age (rather than 1.6667 x AFC x years of creditable service)

A guaranteed annual benefit adjustment (GABA) is payable on January 1st of each calendar year for each retiree who has received at least 36 monthly retirement benefit payments prior to that date. The GABA is applicable to both Tier One and Tier Two members. The GABAs calculated prior to July 1, 2013, were 1.5% of the benefit payable as of January 1st. Effective July 1, 2013, the GABA to be calculated each year may vary from 0.5% to 1.5% based on the retirement system's funding status and the period required to amortize any unfunded accrued actuarial liability as determined in the prior actuarial valuation. The legislative enactment that allows for reduction of the GABA is currently being litigated. A temporary restraining order requires

continued calculation of the GABA at the full 1.5% rate for Tier One members pending resolution of the litigation.

Overview of Contributions

The TRS funding policy provides for monthly employee and employer contributions at rates specified by state law. Plan members, for the fiscal year ending June 30, 2014, were required to contribute 8.15% of their earned compensation. TRS employers were required to contribute 8.47% of earned compensation for school districts and community colleges. The State's General Fund contributes an additional 2.38% of earned compensation for school district and community college employers. The State's General Fund also contributes an additional .11% of total earned compensation of all TRS members. Each employer in the Montana University System contributes to the TRS a supplemental employer contribution currently at a rate of 4.72% of the total compensation of employees participating in the Montana University System Retirement Program (MUS-RP).

Contribution rates for FY 2013, 2014 and 2015 for school district and community college employers are listed below.

Fiscal Year	Member Rate	Employer Rate	State Contribution	Total
July 1, 2009 to June 30, 2013	7.15%	7.47%	2.49%	17.11%
July 1, 2013 to June 30, 2014	8.15%	8.47%	2.49%	19.11%
July 1, 2014 to June 30, 2015	8.15%	8.57%	2.49%	19.21%

Contribution rates for FY 2013, 2014 and 2015 for state agencies and the University System, employers are listed below.

Fiscal Year	Members	Employers	General Fund	Total
July 1, 2009 to June 30, 2013	7.15%	9.85%	0.11%	17.11%
July 1, 2013 to June 30, 2014	8.15%	10.85%	0.11%	19.11%
July 1, 2014 to June 30, 2015	8.15%	10.95%	0.11%	19.21%

Pursuant to 19-20-609, MCA, the employer contribution rate will increase by 0.10% each year beginning July 1, 2014 through fiscal year 2024.

NOTE B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The TRS, a discretely presented component unit Pension Trust Fund of the State of Montana financial reporting entity, prepares its financial statements using the accrual basis of accounting. Employee and employer contributions are recognized as revenues in the period when due pursuant to statutory requirements and investment income is recognized when earned. Benefit and withdrawal payments are recorded in the period in which the liabilities are due and payable.

The System adheres to all applicable Governmental Accounting Standards Board (GASB) Statements.

GASB Statement No. 67 which was adopted during the year ended June 30, 2014, addresses accounting and financial reporting requirements for pension plans. The statement requires changes in presentation of the financial statements, notes to the financial statements, and required supplementary information. Significant changes include an actuarial calculation of total and net pension liability. It also includes comprehensive footnote disclosure regarding the pension liability, the sensitivity of the net pension liability to the discount rate, and increased investment activity disclosures. The implementation of GASB No. 67 did not significantly impact the accounting for accounts receivable and investment balances. The total pension liability, determined in accordance with GASB No. 67, is presented in Note D.

Prior Period Adjustments

Prior period adjustments reported in the accompanying financial statements relate to corrections of errors and/or changes in accounting policy from prior periods. The adjustment is related to a statewide Other Post Employment Benefit (OPEB) Implicit Rate Subsidy. The rate subsidy was allocated to all state agencies and resulted in a prior period adjustment for TRS in the amount of $92,965 for FY 2014.

Compensated Absences

Compensated absences represent 100 percent of accrued vacation and 25 percent of accrued sick leave for TRS personnel at June 30, 2014.

Investments

The Montana Board of Investments (BOI) manages the State's Unified Investment Program, which includes the TRS plan investments as required by Section 19-20-501, Montana Code Annotated. Per the Montana Constitution, Article VIII Section 13(3), investment of TRS assets shall be managed in a fiduciary capacity in the same manner that a prudent expert acting in a fiduciary capacity and familiar with the circumstances would use in the conduct of an enterprise of a similar character with similar aims. Investments administered by the BOI for the TRS are subject to their investment risk policies. Information on investment policies, investment activity, investment management fees and a listing of specific investments owned by the pooled asset accounts can be obtained from Board of Investments at P.O. Box 200126, Helena, MT 59620-0126.

Cash and cash equivalents consist of funds deposited in the State Treasurer's pooled cash account and cash invested in the Short-Term Investment Pool (STIP). Pooled investments other than STIP are reported at the fair value of each unit times the number of units owned. STIP is recorded at $1 per unit for each unit held. The fair value of publicly traded stocks and bonds is determined by reference to market prices supplied by State Street Bank (the custodial bank). Because a public market does not exist for private equity and real estate investments, the fair value of these investments is the value reported in the most recent external managers' valuation reports.

The TRS investments include: STIP; Retirement Funds Bond Pool (RFBP); Montana Domestic Equity Pool (MDEP); Montana International Equity Pool (MTIP); Montana Private Equity Pool (MPEP), Montana Real Estate Pool (MTRP). Other Investments consist of a portfolio of Structured Investment Vehicles (SIVs) at June 30, 2014.

TRS Cash Equivalent and Investment Portfolio
June 30, 2014

Investment	Book Value	Fair Value
Short-term Investment Pool	$ 74,226,611	$ 74,226,611
Retirement Funds Bond Pool	712,746,462	784,722,676
MT Domestic Equities Pool	405,692,561	1,418,121,811
MT International Equities Pool	359,998,684	643,364,706
MT Private Equities Pool	175,831,117	379,372,922
MT Real Estate Pool	284,602,238	312,839,655
Other Asset Backed Securities	1,142,819	1,142,819
Total	$ 2,014,240,493	$ 3,613,791,200

The investment risks for the pooled investments that TRS participates in are described in the following paragraphs. Investments are administered by the BOI, for the TRS, as part of the State of Montana's Unified Investment Program and are responsible for setting investment risk policies.

Credit Risk – Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation.

Custodial Credit Risk - Custodial credit risk is the risk that, in the event of the failure of the counterparty to a transaction, the BOI may not be able to recover the value of the investment or collateral securities that are in the possession of an outside party.

Concentration of Credit Risk – Concentration of credit risk is the risk of loss attributed to the magnitude of an investor's investment in a single issuer.

Foreign Currency Risk – Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. Currency exposures may be hedged, in a defensive manner, at the discretion of the active managers to preserve the U.S. dollar value of investments made. The managers are not allowed to engage in currency speculation, such as over-hedging, reverse hedging, cross-hedging or other trading activity not specifically aimed at minimizing risk versus their benchmark or preserving the U.S. dollar value of investments.

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. In accordance with GASB Statement No. 40, the BOI selected the effective duration method to disclose interest rate risk.

All securities in pools are held in the name of the Montana BOI, or were registered in the nominee name for the Montana BOI and held in the possession of the BOI's custodial bank. MDEP, MTIP, MPEP, and MTRP do not invest in debt securities, so interest rate risk, credit risk,

and concentration of credit risk do not apply to these holdings. According to GASB Statement No. 40, interest rate disclosures are not required for STIP since STIP is a 2a7-like pool. STIP, as an external investment pool, has not been rated. RFBP consists of corporate bonds (rated), international government bonds, municipal government bonds, sovereign bonds, U.S. government direct obligations, and U.S. government agency.

The TRS investments subject to credit and interest rate risk at June 30, 2014 are categorized below:

Investment	Fair Value 6/30/14	Credit Quality Rating 6/30/14	Effective Duration 6/30/14
RFBP	$ 784,722,676	A+	5.07
STIP	74,226,611	NR	N/A

With the exception of the U.S. Government securities, the RFPB fixed income instruments have credit risk as measured by major credit rating services. Obligations of the U.S. Government or obligation explicitly guaranteed by the U.S. Government are not considered to have credit risk and do not require disclosure of credit quality. The total fixed income investments credit quality of rating for RFBP is not rated (NR).

MPEP, MTRP, MTIP, and RFBP include assets subject to foreign currency risk. TRS' position in these pools is approximately 37% at June 30, 2014. The Montana BOI MPEP and MTRP investments in EURO currency had a fair value of $45,386,016 at June 30, 2014. The Montana BOI MTIP and RFBP had cash and securities with a foreign currency value of $479,669,027 at June 30, 2014.

Securities Lending – Under the provisions of state statutes, BOI is authorized to lend its securities and has contracted with the custodial bank to lend the BOI securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The custodial bank is required to maintain collateral equal to 102 percent of the fair value of domestic securities and 105 percent of the fair value of international securities while the securities are on loan. The BOI and the custodial bank split the earnings, 80/20% respectively, on security lending activities. The BOI retains all rights and risks of ownership during the loan period. At June 30, 2014, the BOI had no credit risk exposure to borrowers. The private equity and real estate pools do not participate in securities lending. There were no failures by any borrowers to return or pay distributions thereon during the period that resulted in a declaration and notice of Default of the Borrower.

NOTE C. PROPERTY and EQUIPMENT

Property and equipment consist of the amounts shown in the following table as of June 30, 2014, and 2013. Assets under $5,000 are expensed in the year purchased. Assets valued at $5,000 or more are recorded at cost less straight-line depreciation over the estimated useful life of five to ten years. Assets valued at $100,000 or more are recorded at recorded at cost less straight-line depreciation over the estimated useful life of five to ten years. There were no significant leases as of June 30, 2014, or 2013. As of June 30, 2014 TRS has completed several modules of its

upgraded pension administration system project (M-Trust). The system upgrade is being implemented on a modular basis with all modules expected to be completed by June 30, 2016. The cost of implementing and upgrading the system as of June 30, 2014 is shown below and on the Basic Financial Statements in the Intangible Assets line item. The upgrade has been recorded in Capital Work in Progress and will be amortized once the project is complete. The Board approved a $2.7 million investment in the upgraded system in the spring of 2014.

		2014		2013
Land and Buildings	$	193,844	$	193,844
Less: Accumulated Depreciation		(150,545)		(150,545)
Equipment		206,696		142,697
Less: Accumulated Depreciation		(132,925)		(110,110)
Intangible Assets, net of amortization		499,184		-
Net Property and Equipment	$	616,255	$	75,886

NOTE D. NET PENSION LIABILITY

Net Pension Liability

	Fiscal Year Ending June, 30 2014
Total Pension Liability	$5,191,069,342
Fiduciary Net Position	3,652,220,265
Net Pension Liability	$1,538,849,077
Ratio of Fiduciary Net Position to Total Pension Liability	70.36%

The net pension liability, the retirement system's total pension liability (TPL) determined in accordance with GASB No. 67 less the fiduciary net position, as of June 30, 2014, is as shown above. The date of the actuarial valuation upon which the TPL is based is July 1, 2014. Roll forward procedures were not used.

Actuarial valuation of the ongoing System involves estimates of the reported amounts and assumptions about probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and future salary increases. Amounts determined regarding the net pension liability are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The most recent experience study was performed in the spring of 2014 for the five year period ending July 1, 2013. The Schedule of Net Pension Liability presents multi-year trend information about whether the plan's fiduciary net position is increasing or decreasing over time relative to the total pension liability. This schedule is presented in the Required Supplementary Information section.

Summary of Actuarial Assumptions

The Total Pension Liability as of June 30, 2014, is based on the results of an actuarial valuation date of July 1, 2014. There were several significant assumptions and other inputs used to measure the total pension liability. The actuarial assumptions used in the July 1, 2014 valuation were based on the results of the last actuarial experience study, dated May 1, 2014. Among those assumptions were the following:

• Total Wage Increases*	8.51%
• Investment Return	7.75%
• Price Inflation	3.25%
• Growth in Membership	0.00%
• Postretirement Benefit Increases (starting three years after retirement)	1.50%
• Interest on Member Accounts	5.00%

*Total Wage Increases include 4.00% general wage increase assumption and 4.51% merit and longevity increases.

Target Allocations

Asset Class	Target Asset Allocation	Real Rate of Return Arithmetic Basis
Broad US Equity	36.00%	4.80%
Broad International Equity	18.00%	6.05%
Private Equity	12.00%	8.50%
Intermediate Bonds	23.40%	1.50%
Core Real Estate	4.00%	4.50%
High Yield Bonds	2.60%	3.25%
Non-Core Real Estate	4.00%	7.50%
	100.00%	

The long-term expected return on pension plan assets is reviewed as part of the regular experience studies prepared every four years for the System. The most recent analysis, performed for the period covering fiscal years 2008 through 2013, is outlined in a report dated May 1, 2014. Several factors are considered in evaluating the long-term rate of return assumption including long term historical data, estimates inherent in current market data, and a log-normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected return, net of investment expense and inflation) were developed by the investment consultant for each major asset class. These ranges were combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and then adding expected inflation. The capital market assumptions developed by the investment consultant are intended for use over a 10-year horizon and may not

be useful in setting the long-term rate of return for funding pension plans which covers a longer timeframe. The assumption is intended to be a long term assumption and is not expected to change absent a significant change in the asset allocation, a change in the inflation assumption, or a fundamental change in the market that alters expected returns in future years. Best estimates of arithmetic real rates of return for each major asset class included in the System's target asset allocation as of June 30, 2014, is summarized in the above table.

The discount rate used to measure the total pension liability was 7.75%. The projection of cash flows used to determine the discount rate assumed that contributions from participating plan members, employers, and non-employer contributing entities will be made based on the Board's funding policy, which establishes the contractually required rates under Montana State Code. These rates are shown in the following tables. In addition to these contributions the State general fund will contribute $25 million annually to the System payable July 1st of each year. Based on those assumptions, the System's fiduciary net position was projected to be adequate to make all the projected future benefit payments of current plan members through the year 2116. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability**.**

History of Legislated Contributions
School District and Other Employers
by percent of covered payroll

	Members	Employers	General fund	Total employee & employer
Prior to July 1, 2007	7.15%	7.47%	0.11%	14.73%
July 1, 2007 to June 30, 2009	7.15%	7.47%	2.11%	16.73%
July 1, 2009 to June 30, 2013	7.15%	7.47%	2.49%	17.11%
July 1, 2013 to June 30, 2014	8.15%	8.47%	2.49%	19.11%
July 1, 2014 to June 30, 2015	8.15%	8.57%	2.49%	19.21%
July 1, 2015 to June 30, 2016	8.15%	8.67%	2.49%	19.31%
July 1, 2016 to June 30, 2017	8.15%	8.77%	2.49%	19.41%
July 1, 2017 to June 30, 2018	8.15%	8.87%	2.49%	19.51%
July 1, 2018 to June 30, 2019	8.15%	8.97%	2.49%	19.61%
July 1, 2019 to June 30, 2020	8.15%	9.07%	2.49%	19.71%
July 1, 2020 to June 30, 2021	8.15%	9.17%	2.49%	19.81%
July 1, 2021 to June 30, 2022	8.15%	9.27%	2.49%	19.91%
July 1, 2022 to June 30, 2023	8.15%	9.37%	2.49%	20.01%
July 1, 2023 to June 30, 2024	8.15%	9.47%	2.49%	20.11%

State and University Employers

	Members	Employers	General Fund	Total
Prior to July 1, 2007	7.15%	7.47%	0.11%	14.73%
July 1, 2007 to June 30, 2009	7.15%	9.47%	0.11%	16.73%
July 1, 2009 to June 30, 2013	7.15%	9.85%	0.11%	17.11%
July 1, 2013 to June 30, 2014	8.15%	10.85%	0.11%	19.11%
July 1, 2014 to June 30, 2015	8.15%	10.95%	0.11%	19.21%
July 1, 2015 to June 30, 2016	8.15%	11.05%	0.11%	19.31%
July 1, 2016 to June 30, 2017	8.15%	11.15%	0.11%	19.41%
July 1, 2017 to June 30, 2018	8.15%	11.25%	0.11%	19.51%
July 1, 2018 to June 30, 2019	8.15%	11.35%	0.11%	19.61%
July 1, 2019 to June 30, 2020	8.15%	11.45%	0.11%	19.71%
July 1, 2020 to June 30, 2021	8.15%	11.55%	0.11%	19.81%
July 1, 2021 to June 30, 2022	8.15%	11.65%	0.11%	19.91%
July 1, 2022 to June 30, 2023	8.15%	11.75%	0.11%	20.01%
July 1, 2023 to June 30, 2024	8.15%	11.85%	0.11%	20.11%

Pursuant to 19-20-609, MCA, the employer contribution rate will increase by 0.10% each year beginning July 1, 2014 through fiscal year 2024.

Sensitivity Analysis

	1.0% Decrease (6.75%)	Current Discount Rate	1.0% Increase (8.75%)
Net Pension Liability	$ 2,137,950,777	$ 1,538,849,077	$ 1,032,700,256

In accordance with GASB 67 regarding the disclosure of the sensitivity of the net pension liability to changes in the discount rate, the above table presents the net pension liability calculated using the discount rate of 7.75%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1.00% lower (6.75%) or 1.00% higher (8.75%) than the current rate.

Schedule of Investment Returns

TRS PLAN
SCHEDULE OF INVESTMENT RETURNS

	2014*
Annual Money Weighted Rate Return, net of Investment Expense	17.18%

**Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.*

The annual money weighted rate of return on pension plan investments expresses investment performance, net of pension plan investment expense, adjusted for the changing amounts actually invested.

NOTE E. CONTRIBUTIONS

The TRS funding policy provides for monthly employee and employer contributions at rates specified by state law. Plan members, for the fiscal year ending June 30, 2014, were required to contribute 8.15% of their earned compensation and the employer contribution rate for fiscal year 2014 was 8.47% of earned compensation. The State's general fund contributed an additional 2.38%, for school district and community college employers, of their members' earned compensation. The State's general fund contributed an additional .11% of total earned compensation of all members. Each employer in the Montana University System contributed 4.72% of the total compensation of employees participating in the Optional Retirement Program (ORP). The schedule (History of Legislated Contributions) above summarizes contribution rates in effect June 30, 2014.

TRS actuary determines the actuarial implications of the funding requirement in annual actuarial valuations. The actuarial method used to determine the implications of the statutory funding level is the entry age actuarial cost method, with both normal cost and amortization of the accrued liability determined as a level percentage of earned compensation. Contribution rates consist of an amount for normal cost, the estimated amount necessary to finance benefits earned by the members during the current year, and an amount for amortization of the unfunded actuarial accrued liability.

Contributions made by employers and members were in accordance with actuarially computed funding requirements. Information with regard to contributions to the System, for the year ended June 30, 2014, is indicated in the Required Supplemental Information, Schedule of Employer Contributions.

NOTE F. OTHER POSTEMPLOYMENT BENEFITS

Plan Description

TRS employees and dependents are eligible to receive health care through the State Group Benefits Plan administered by the Montana Department of Administration (MDOA). In accordance with Section 2-18-704, MCA, the State provides optional post-employment medical, vision and dental health care benefits for retirees and their dependents and beneficiaries that elect to continue coverage and pay administratively established premiums. Plan coverage is on a calendar year basis. For GASB 45 reporting, the State Group Benefits Plan is considered an agent multiple-employer plan and TRS is considered to be a separate employer participating in the plan. Information about the State of Montana Other Postemployment Benefits (OPEB) can be obtained from the Department of Administration, State Financial Services Division, at P.O. Box 200102, Helena, MT 59620-0102.

The plan allows retirees to participate, as a group, at a rate that does not cover all of the related costs. This results in the reporting of an "implied rate" subsidy in the related financial

statements and footnotes. While this liability is disclosed for financial statement purposes, it does not represent a legal liability of the TRS.

Funding Policy

The contribution requirements of plan members are established and may be amended by the MDOA. The monthly premium for plan members ranges from $299 to $1,061 for calendar year 2013 depending on the medical plan selected, family coverage, and Medicare eligibility. The plan is financed on a pay-as-you-go basis.

Annual OPEB Cost

The annual required contribution (ARC), an actuarially determined rate in accordance with the parameters of GASB Statement No. 45, represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.

Annual OPEB Cost

	TRS
Annual required contribution/OPEB cost	$ 60,733
Interest on net OPEB obligation	11,096
Amortization on net OPEB obligation	(13,756)
Annual OPEB cost	58,073
Contributions made	12,188
Increase in net OPEB obligation	45,885
Net OPEB obligation – beginning of year (restated)	194,444
Net OPEB obligation – end of year	$240,329

The 2014 ARC is calculated for all the plan's employers and then allocated to each participating employer. The TRS 2014 ARC is $60,733 and is based on the plan's current ARC rate of 5.69% percent of total annual covered payroll for all employers. The 2014 ARC is equal to an annual amount required each year to fully fund the liability over 30 years. The amount of the estimated OPEB actuarial accrued liability was determined in accordance with GASB Statement 45, and the liability for TRS is estimated at $493,412. (The actuarial accrued liability is the present value of future retiree benefits and expenses.) For fiscal year 2014, the TRS allocated annual OPEB cost (expense) was $58,073. The June 30, 2013 figure has been restated due to a change in calculation of annual OPEB costs, which did not previously include adjustments for amortization. The TRS annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for 2014 and the five preceding years were as follows:

Fiscal Year Ended		Annual OPEB Cost	% of Annual OPEB Cost Contributed		Net OPEB Obligation	
6/30/2009	$	73,242	14.6%	$	70,473	Restated
6/30/2010		59,948	20.4%		96,844	Restated
6/30/2011		62,837	27.9%		134,832	Restated
6/30/2012		59,112	9.4%		164,529	Restated
6/30/2013		59,793	12.0%		194,444	Restated
6/30/2014		58,073	21.0%		240,329	

Funded Status and Funding Progress

Other Postemployment Benefits Plan Information
Schedule of Funding Progress
(All dollar amounts in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)		Actuarial Accrued Liability (AAL) (b)	Unfunded (UAAL) (b-a)	Funded Ratio (a/b)	Annual Covered Payroll (c)	UAAL as % of covered Payroll ((b-a/c)
12/31/2007	-	$	449,321	$ 449,321	0%	519,969	86.41%
12/31/2009	-	$	357,664	$ 357,664	0%	526,794	67.89%
12/31/2011	-	$	361,053	$ 361,053	0%	558,646	64.63%
12/31/2013	-	$	493,412	$ 493,412	0%	828,985	59.52%

The funded status of the TRS allocation of the plan as of December 31, 2013, the most recent valuation date was as follows:

Actuarial accrued liability (AAL)	$493,412
Actuarial value of plan assets	$ 0
Unfunded actuarial accrued liability (UAAL)	$493,412
Funded ratio (actuarial value of plan assets/AAL)	0
TRS Covered payroll (active plan members)	$828,985
UAAL as a percentage of covered payroll	59.52%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the ployer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. Actuarial calculations reflect a long-term

perspective. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Projections of benefits for financial reporting progress are based on the substantive plan (the plan as understood by the employer and the plan members), and includes the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and plan members in the future.

OPEB Plan Actuarial Methods and Assumptions

As of December 31, 2013, the TRS actuarially accrued liability (AAL) for benefits was $493,412, with no actuarial value of assets, resulting in an unfunded actuarial accrued liability (UAAL) of $493,412, and the ratio of the UAAL to the covered payroll was 59.52%. The UAAL is being amortized as a level dollar amount over an open basis for 30 years.

In the December 31, 2013, actuarial valuation, the projected unit credit funding method was used for the State. The actuarial assumptions included a 4.25% discount rate and a 2.50% payroll growth rate. The projected annual healthcare cost trend rate is 10.0% for 2013 and decreases by 0.5% per year down to 5% for 2023 and beyond for medical and 10.0% for prescription drugs decreasing by 1% to 5% at 2018 and beyond.

NOTE G. PENDING LITIGATION

The actuarial valuation for the retirement system as of July 1, 2014, included consideration for a plan change made in the 2013 Montana legislative session that authorized a reduction in the statutory "guaranteed annual benefit adjustment" ("GABA" – referred to as a cost of living adjustment in other systems), which reduction would apply to current TRS retirees and active members as well as to new hires. The prior GABA was a non-variable 1.5%, compounding, annual benefit adjustment applied each January 1st to the benefits of members who had received at least 36 monthly benefit payments as of that date. The 2013 legislative change, codified at 19-20-719(1), MCA, and effective July 1, 2013, is summarized as follows:

- GABA must be decreased to .50% if the most recent actuarial valuation shows that retirement system liabilities are less than 90% funded
- If the most recent actuarial valuation shows that retirement system liabilities are at least 90% funded and the provision of the increase is not projected to cause the system's liabilities to be less than 85% funded, the GABA must increase from the .5% floor up to 1.5%, as set by the retirement board

In October 2013, litigation was filed by Plaintiffs who were/are active members or retirees of TRS as of July 1, 2013, challenging the constitutionality of the GABA reduction under the "contract rights" and "takings" provisions of the Montana Constitution, and requesting a preliminary injunction. In December, 2013, the Court granted the Plaintiffs' motion for a

preliminary injunction, which prohibited TRS from reducing the GABA pending the Court's decision in the pending litigation. In January, 2014 and again in January, 2015, the GABA calculated for eligible benefit recipients was 1.5% rather than the reduced rate of 0.5% that would have been calculated pursuant to 19-20-719(1), MCA (2013), but for the preliminary injunction.

Both parties to the litigation filed motions for summary judgment, with briefing concluded in November, 2014. Oral argument on the cross-motions for summary judgment will be heard in March, 2015. TRS cannot predict when the District Court will then issue a decision, but it is likely that the District Court's decision will be appealed to the Montana Supreme Court regardless which party prevails in the district court.

The GABA will continue to be calculated at the 1.5% rate pending the District Court's decision, and may continue to be calculated at the 1.5% rate pending a decision on appeal to the Supreme Court, either because the Plaintiffs prevail at the District Court level, or because the Plaintiff's seek and are granted a preliminary injunction pending appeal. If the Plaintiffs ultimately prevail in the litigation, the long-term value of the retirement system's Unfunded Actuarial Accrued Liability (UAAL) will increase over the UAAL that would be calculated based on the reduced GABA provided for in 19-20-719(1), MCA (2013).

Anticipating that a lawsuit would likely be filed contesting the constitutionality of the GABA adjustment, for comparison purposes, TRS asked its contract actuary to also provide an actuarial valuation of the system as of July 1, 2013 assuming the GABA continued at the pre July 1, 2013 rate. The comparison actuarial analysis indicated the TRS amortization period would be 20 years under the new GABA provision and 29 years under the old GABA provision with an increase in UAAL from $1.524 billion to $1.895 billion and a Funded Ratio decrease from 66.8% to 61.81%.

In light of the preliminary injunction resulting in current calculation and payment of the GABA at the pre July 1, 2013 rate of 1.5%., TRS's contract actuary completed TRS's primary annual actuarial valuation as of July 1, 2014 assuming an on-going GABA of 1.5%. Again, TRS requested that its contract actuary provide a comparison actuarial analysis based on the reduced GABA rate as set forth in 19-20-719(1), MCA (2013). The actuarial valuation as of July 1, 2014 indicates the TRS amortization period, change in UAAL, and funded ratio under the current GABA rate (1.5%) and the reduced GABA rate (0.5%) would be:

	1.5% GABA	0.5% GABA
Amortization Period	28 years	17 years
Total UAAL	$1.793 billion	$1.388 billion
Funded Ratio	65.45%	70.99%

While the actuarial comparison analysis likely does not completely accurately describe what the actuarial valuation would end up being depending on all determinations that might be made by the District Court and Supreme Court in the litigation, it provides a reasonable estimate of the potential outcome.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Changes in the Net Pension Liability

Schedule of Changes in the Net Pension Liability	2014*
Total Pension Liability	
Service Cost	77,006,174
Interest	373,456,442
Benefit Changes	-
Difference Between Expected and Actual Experience	20,297,029
Changes of Assumptions	46,502,421
Benefit Payments	(285,182,358)
Refunds of Contributions	(4,788,688)
Net change in Total Liability	227,291,020
Total Pension Liability Beginning	4,963,778,322
Total Pension Liability Ending (a)	5,191,069,342
Plan Net Position	
Contributions - Employer	83,439,612
Contributions - Member	70,468,354
Contributions - Non-Employer Contributing Entities	64,923,320
Misc. Income	6,000
Net Investment Income	540,277,362
Benefit Payments	(285,182,358)
Administrative Expenses	(2,022,636)
Refund of Contributions	(4,788,688)
Other	(58,073)
Net Change in Plan Net Position	467,062,894
Plan Net Position - Beginning	3,185,064,406
Prior Period Adjustment	92,965
Plan Net Position - Ending (b)	3,652,220,265
Net Pension Liability - Ending (a - b)	1,538,849,077

**Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.*

Schedule of the Net Pension Liability

Schedule of the Net Pension Liability

	2014*
Total Pension Liability	5,191,069,342
Plan Net Position	3,652,220,265
Net Pension Liability	1,538,849,077
Ratio of Plan Net Position to Total Pension Liability	70.36%
Covered -Employee Payroll	750,604,063
Net Pension Liability as a Percentage of Covered-Employee Payroll	205.01%

**Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.*

Schedule of Investment Returns

TRS PLAN
SCHEDULE OF INVESTMENT RETURNS
Year Ended June 30, 2014

	2014*
Annual Money Weighted Rate Return, net of Investment Expense	17.18%

**Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.*

Schedule of Employer and Non-Employer Contributing Entities Contributions

Schedule of Employer and Non-Employer Contributing Entities Contributions

	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005
Actuarially Determined Employer Contributions	$ 148,362,932	$ 130,533,530	$ 108,993,492	$ 91,879,263	$ 90,967,180	$ 80,997,968	$ 81,414,325	$ 40,807,133	$ 42,768,730	$ 57,806,176
Actual Contributions:										
Employers	83,439,612	74,113,191	72,422,404	72,879,950	72,179,128	66,850,644	67,921,950	61,943,986	58,268,941	57,150,364
Non-Employer Contributing Entities	64,923,320	17,521,347	16,843,766	17,437,366	17,241,610	14,147,324	13,492,375	720,266	693,226	655,812
Total	148,362,932	91,634,538	89,266,170	90,317,316	89,420,738	80,997,968	81,414,325	62,664,252	58,962,167	57,806,176
Annual Contribution Deficiency / (Excess)	-	38,898,992	19,727,322	1,561,947	1,546,442	-	-	(21,857,119)	(16,193,437)	-
Covered - Employee Payroll	750,604,063	742,608,987	735,586,961	746,694,434	747,037,330	683,235,462	657,435,444	664,100,000	636,000,000	612,600,000
Actual Contributions as a Percentage of Covered-Employee Payroll	19.77%	12.34%	12.14%	12.10%	11.97%	11.86%	12.38%	9.44%	9.27%	9.44%

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

Note A. Schedule of Changes in the Net Pension Liability and Schedule of Net Pension Liability

The total pension liability contained in these schedules was provided by the Systems actuary, Cavanaugh Macdonald Consulting, LLC. The net pension liability is measured as the total pension liability less the amount of the fiduciary net position of the Retirement System.

Note B. Schedule of Employer Contributions

The actuarially determined employer contributions and amount of those contributions actually made are presented in the schedule.

Note C. Actuarial Assumptions

The information presented in the required supplementary schedules was used in the actuarial valuation for purposes of determining the actuarially determined contribution rate. The assumptions and methods used for this actuarial valuation were recommended by the actuary and adopted by the Board. Additional information as of the latest actuarial valuation follows.

Changes of Benefit Terms

The following changes to the plan provision were made as identified:

The 2013 Montana Legislature passed HB 377 which provides additional revenue and created a two tier benefit structure. A Tier One Member is a person who first became a member before July 1, 2013 and has not withdrawn their member's account balance. A Tier Two Member is a person who first becomes a member on or after July 1, 2013 or after withdrawing their member's account balance, becomes a member again on or after July 1, 2013.

The GABA for Tier 1 members has also been modified as follows:

- If the most recent actuarial valuation of the System shows that the funded ratio is less than 90%, then the maximum increase that can be granted is 0.50%.
- If the funded ratio is at least 90% and the increase is not projected to cause the System's funded ratio to be less than 85%, an increase can be granted that is greater than 0.50% but not more than 1.50%.

The second tier benefit structure for members hired on or after July 1, 2013 is summarized below.

(1) **Final Average Compensation**: average of earned compensation paid in five consecutive years of full-time service that yields the highest average

(2) **Service Retirement:** Eligible to receive a service retirement benefit if the member has been credited with at least five full years of creditable service and has attained the age of 60; or has been credited with 30 or more years of full-time or part-time creditable service and has attained age 55
(3) **Early Retirement**: Eligible to receive an early retirement allowance if a member is not eligible for service retirement but has at least five years of creditable service and attained age 55
(4) **Professional Retirement Option**: if the member has been credited with 30 or more years of service and has attained the age of 60 they are eligible for an enhanced allowance equal to 1.85% of average final compensation times all service at retirement . Otherwise, the multiplier used to calculate the retirement allowance will be equal to 1.67%
(5) **Annual Contribution**: 8.15% of member's earned compensation
(6) **Supplemental Contribution Rate**: On or after July 1, 2023, the TRS Board may require a supplemental contribution up to 0.5% if the following three conditions are met:
    a. The average funded ratio of the System based on the last three annual actuarial valuations is equal to or less than 80%; and
    b. The period necessary to amortize all liabilities of the System based on the latest annual actuarial valuation is greater than 20 years; and
    c. A State or employer contribution rate increase or a flat dollar contribution to the Retirement System Trust fund has been enacted that is equivalent to or greater than the supplemental contribution rate imposed by the TRS Board.
(7) **Disability Retirement:** A member will not be eligible for a disability retirement if the member is or will be eligible for a service retirement on the date of termination
(8) **Guaranteed Annual Benefit Adjustment (GABA)**:
    a. If the most recent actuarial valuation shows that Retirement System liabilities are at least 90% funded and the provision of the increase is not projected to cause the System's liabilities to be less than 85% funded, the GABA may increase from the 0.5% floor up to 1.5%, as set by the Board.

HB 377 increased revenue from the members, employers and the State as follows:

- Annual State contribution equal to $25 million paid to the System in monthly installments.
- One-time contribution payable to the Retirement System by the trustees of a school district maintaining a retirement fund. The one-time contribution to the Retirement System shall be the amount earmarked as an operating reserve in excess of 20% of the adopted retirement fund budget for the fiscal year 2013. The amount received was $22 million in FY 2014.
- 1% supplemental employer contribution. This will increase the current employer rates:
    - School Districts contributions will increase from 7.47% to 8.47%
    - The Montana University System and State Agencies will increase from 9.85% to 10.85%.
    - The supplemental employer contribution will increase by 0.1% each fiscal year for fiscal year 2014 thru fiscal year 2024. Fiscal years beginning after June 30, 2024 the total supplemental employer contribution will be equal to 2%.
- Members hired prior to July 1, 2013 (Tier 1) under HB 377 are required to contribute a supplemental contribution equal to an additional 1% of the member's earned compensation.

- Each employer is required to contribute 9.85% of total compensation paid to all re-employed TRS retirees employed in a TRS reportable position to the System.

Changes in Actuarial Assumptions and Methods

The following changes to the actuarial assumptions were adopted in 2014:

- Assumed rate of inflation was reduced from 3.50% to 3.25%
- Payroll Growth Assumption was reduced from 4.50% to 4.00%
- Assumed real wage growth was reduced from 1.00% to 0.75%
- Investment return assumption was changed from net of investment and administrative expenses to net of investment expenses only.
- Mortality among contributing members, service retired members, and beneficiaries was updated to the following:

  For Males: RP 2000 Healthy Annuitant Mortality Table for ages 50 and above and the RP 2000 Combined Healthy Annuitant Mortality Table for ages below 50, set back four years, with mortality improvements projected by Scale BB to 2018.

  For Females: RP 2000 Healthy Annuitant Mortality Table for ages 50 and above and the RP 2000 Combined Healthy Annuitant Mortality Table for ages below 50, set back two years, with mortality improvements projected by Scale BB to 2018.

- Mortality among disabled members was updated to the following:

  For Males: RP 2000 Disabled Mortality Table for Males, set forward one year, with mortality improvements projected by Scale BB to 2018.

  For Females: RP 2000 Disabled Mortality Table for Females, set forward five years, with mortality improvements projected by Scale BB to 2018.

Method and assumptions used in calculations of actuarially determined contributions

Actuarial cost method	Entry age
Amortization method	Level percentage of pay, open
Remaining amortization period	28 years
Asset valuation method	4-year smoothed market
Inflation	3.25 percent
Salary increase	4.00 to 8.51 percent, including inflation for Non-University Members and 5.00% for University Members;
Investment rate of return	7.75 percent, net of pension plan investment expense, and including inflation

Other Postemployment Benefits Plan Information
Schedule of Funding Progress
(All dollar amounts in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded (UAAL) (b-a)	Funded Ratio (a/b)	Annual Covered Payroll (c)	UAAL as % of covered Payroll ((b-a/c)
12/31/2007	-	$ 449,321	$ 449,321	0%	519,969	86.41%
12/31/2009	-	$ 357,664	$ 357,664	0%	526,794	67.89%
12/31/2011	-	$ 361,053	$ 361,053	0%	558,646	64.63%
12/31/2013	-	$ 493,412	$ 493,412	0%	828,985	59.52%

The funded status of the TRS allocation of the plan as of December 31, 2013, the most recent valuation date was as follows:

Actuarial accrued liability (AAL)	$493,412
Actuarial value of plan assets	$ 0
Unfunded actuarial accrued liability (UAAL)	$493,412
Funded ratio (actuarial value of plan assets/AAL)	0
TRS Covered payroll (active plan members)	$828,985
UAAL as a percentage of covered payroll	59.52%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. Actuarial calculations reflect a long-term perspective. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Projections of benefits for financial reporting progress are based on the substantive plan (the plan as understood by the employer and the plan members), and includes the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and plan members in the future.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
SUPPORTING SCHEDULES / SUPPLEMENTARY INFORMATION
FISCAL YEARS ENDED JUNE 30, 2014

SCHEDULE OF ADMINISTRATIVE EXPENSES

Expenses for the administration of the plan, excluding compensated absences, depreciation and amortization, are budgeted and approved by the TRS Board. The administrative costs of the TRS are financed through realized investment income. The expenses, less amortization of intangible assets, may not exceed 1.5% of retirement benefits paid. Administrative expenses for the fiscal year ended June 30, 2014 are outlined below:

		2014
Administrative Expenses:		
Personnel Services:		
Salaries	$	972,133
Other Compensation		3,750
Employee Benefits		309,987
Total Budgeted Personal Services	$	1,285,871
Operating Expenses:		
Contracted Services	$	450,749
Supplies & Material		44,026
Communications		93,308
Travel		23,889
Rent		58,517
Repair & Maintenance		26,912
Other Expenses		65,544
Total Budgeted Operating Expenses	$	762,945
Non-Budgeted Expenses:		
Compensated Absences	$	(48,994)
Depreciation		22,815
Amortization of Intangible Assets		-
Total Non-Budgeted Expenses	$	(26,179)
Total Administrative Expenses	**$**	**2,022,636**

Schedule of Investment Expenses

		Custodial	External		
Investment	BOI	Bank	Managers	Other	Total
Short-term Investment Pool	$ 13,085	$ 4,866		$ 130,118	$ 148,068
Retirement Funds Bond Pool	$ 249,833	$ 73,184	$ 567,424	$ 1,977	$ 892,418
Montana Domestic Equity Pool	$ 226,770	$225,615	$ 3,178,474	$1,234,597	$ 4,865,456
Montana International Pool	$ 202,672	$ 50,603	$ 1,235,628	$ 221,096	$ 1,709,999
Montana Private Equity Pool	$ 364,388	$ 44,916	$ 7,324,279	$ 808,927	$ 8,542,510
Montana Real Estate Pool	$ 219,182	$ 32,633	$ 3,603,187	$ 0	$ 3,855,003
Totals	**$1,275,930**	**$431,816**	**$15,908,993**	**$2,396,715**	**$20,013,455**

SCHEDULE OF PAYMENTS TO CONSULTANTS

Costs included in the table below are a result of administrative expenses, as well as several costs associated with the M-Trust project (Intangible Assets - Capital Work in Progress)

	2014
Actuarial Services	$ 77,980
Consulting Services	89,912
Legal Services	54,594
Medical Evaluations	225
Information Technology Services	458,672
Total Consultant Payments	**$ 681,383**

Teachers' Retirement System

System Response

TEACHERS' RETIREMENT SYSTEM

STEVE BULLOCK, GOVERNOR

www.trs.mt.gov

STATE OF MONTANA

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HELENA, MONTANA 59620-0139

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February 11, 2015

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LEGISLATIVE AUDIT DIV.

Tori Hunthausen, Legislative Auditor
Legislative Audit Division
Room 160, State Capitol
PO Box 201705
Helena MT 59620-1705

Dear Ms. Hunthausen:

Thank you for the opportunity to reply to the financial audit report of the Teachers' Retirement System for the fiscal year ending June 30, 2014. The Teachers' Retirement Board appreciates the services provided by your staff in conducting the audit. The funded status and amortization period for the Teachers' Retirement System continues to improve as a result of the legislation passed and approved during the 2013 Legislative Session in addition to favorable investment returns. As of July 1, 2014, the system is 65.5% funded and can fully amortize any unfunded liabilities in 28 years.

We are pleased with the unmodified opinion on the financial statements for the fiscal year ending June 30, 2014 and I would like to thank Ms. Hunthausen and her staff for their professionalism and courtesy as they conducted the audit.

Sincerely,

Shawn J. Graham
Executive Director
Teachers' Retirement System